



HOUSE OF LORDS

Industry and Regulators Committee

Corrected oral evidence: Parliamentary scrutiny of regulators

Tuesday 24 May 2022

10.30 am

Watch the meeting

Members present: Lord Hollick (The Chair); Lord Agnew of Oulton; Lord Blackwell; Baroness Bowles of Berkhamsted; Lord Cromwell; Baroness Donaghy; Lord Reay; Lord Sharkey.

Evidence Session No. 2

Heard in Public

Questions 11 - 29

Witness

[I](#): Sir Paul Tucker, Research Fellow, Harvard Kennedy School.

Examination of witness

Sir Paul Tucker.

Q11 **The Chair:** Sir Paul, I welcome you to the Industry and Regulators Committee. As our title suggests, we take a particular interest in regulators and their performance. We are proposing to call probably four or five regulators over the coming months, to review their remit, look at their performance and generally agree—or seek to agree—with them what steps they need to take to improve their overall performance. Our first call for evidence on that front is to Ofwat.

You have written extensively about regulators and their relationship with Parliament in your book *Unelected Power: The Quest for Legitimacy in Central Banking and the Regulatory State*. It might be helpful to start off with an independent agency with which you are particularly familiar; namely, the Bank of England and the Monetary Policy Committee, which, as you know, has somewhat hit the headlines over the last few weeks. Could you reflect on the events of the last few weeks in the context of the relationship between an independent agency, the Government and of course Parliament?

Particularly strong remarks have been made about the MPC's action, or inaction, in the context of addressing inflation. Some of those comments seemed to imply—or one can infer from them—that the MPC has a slightly wider duty than possibly was originally envisaged. One of the perspectives that would be helpful is outlined in your book, where you talk about the confusion of objectives and how it is better to have one clear objective, such as 2% inflation, and to go for it. Trying to crowd in a few "having regard to" secondary and tertiary objectives rather confuses the situation and possibly leads to the sort of debate that we have had over the last few weeks. So I invite you to give us your reflection on the debates of the last few weeks in the context of the relationship between Parliament, the Government and the Bank of England.

Sir Paul Tucker: Thank you for inviting me, Chair. It is nice for me to get to give evidence on regulation other than on central banking, although I will begin with that. This book is often cast as being about central banking, but it is not; it is about unelected power in democracies, which I care about rather more than central banking.

On where you ended up, my answer is: yes. For independent agency-managed regimes, one has to make what I think is a vital distinction between accountability for the design of the regime and accountability for its stewardship. The monetary policy regime is going rather well, in that inflation is above 2% and people are asking why on earth that is. However, for some of the other independent agency regulatory regimes of the UK, the public, media commentators and you and your counterparts in the Commons cannot crystalise questions quite so sharply. So that is good.

This is not just about the UK: Jay Powell, the chair of the Federal Reserve, has been under tremendous pressure, as has the ECB, although

in somewhat more complicated circumstances, to be fair, because it does not have a fiscal authority. One of the questions is: have regulators been deflected from their core responsibilities? There are two ways in which they could be. One is that there is an opportunity cost. I do not particularly have the Bank of England in mind here; I am more thinking of the ECB, although there is not nothing for the Bank of England. Every time you give a speech on climate change, inequality or other social justice issues, you are not doing the thing that only you can do. Unless they have become much better at writing speeches and thinking about monetary policy than I saw in Eddie George and Mervyn King, who were rather good at it, the opportunity cost is to be taken seriously. My point is: concentrate on the thing that only you can do.

I try to make a deeper point in my book, although I do not think that I have sufficiently put it in capital letters. Everyone knows that it is a bad idea to have elected politicians setting monetary policy, not least because they can take the latent power of taxation away from Parliament—there is a separation of powers argument for monetary independence. But that just means that elected people should not do it; it does not mean that unelected people would be any good at it. Those unelected people have to be harnessed to their incentives for professional esteem and public prestige for delivering this mandate. However—I am now thinking of a very big non-UK central bank—if inflation runs away from you but you are nevertheless perceived as a social justice champion and a champion against climate change, the esteem and the prestige that you personally want and which lift you up in the world might remain intact, even though *Bild* is saying that you are the worst person in the world. So the design of the regimes has to harness these people—people like me, in the past.

More practically, the questions that either the Lords Economic Affairs Committee or the Treasury Committee in the Commons might be asking the Bank are essentially twofold. I have no idea whether this is true, but it is said that 80% of the increase in inflation is attributable to war, Covid and so on, which sounds not implausible. But 20% of a sizeable number is not small. Let us say that inflation is 10% and that 20% of 8% is 2%, which of course is not right—we can say that 3.5% or 4% inflation is attributable not to Covid or the war but to excess demand. How did that come about? The explanation may be that there has been what economists would call a hit to the productive part of the economy, due to long Covid and people deciding that they do not want to return to work. The job of a central bank is not to say, “We’re not going to slow the economy down.” But you have to bring demand down into line with the now shallower path of supply.

But the biggest question of all to ask monetary policymakers—right now would be a good time to ask it—is always: do you think that you are currently restraining demand or stimulating it? If the ECB was asked that question, it would struggle to avoid the answer, “We are still stimulating the economy”. Yesterday, the president of the ECB said that it was going to move away from negative rates in the third quarter of this year. Unless it thinks that the underlying so-called equilibrium or invisible rate is

highly negative, it thinks that it is still stimulating the economy. So one question that should be asked is: are you restraining or stimulating the economy, or neither, and why?

Occasions—not quite like this—with officeholders are tremendously important for asking simple questions that go to the heart of the mandate. But, to join up what I was saying, to do that the mandate has to be clear; otherwise, if I have lots of mandates, you could ask me a question about something and I could take it into something else that is equally important in terms of the public and the welfare of this country.

Q12 The Chair: Sticking with the interest rate issue, were you still on the MPC, would it be your view that interest rates need to be pushed higher, notwithstanding the fact that that would be an additional burden on consumers?

Sir Paul Tucker: Perhaps, but the truth is that I am not close enough to the data to know. I am better at coming up with the questions that should be put, rather than the answers. It is also useful not to pretend that you are still who you were.

However, I am clear about two things. I have been on the record, as they say these days, for a while about this. The “quantitative easing”—I am deliberately putting that in quotes—that the Fed and the Bank of England did in March, April and perhaps May 2020, when Covid was just exploding, as it were, was essentially designed to stabilise the gilt and Treasury bond markets, which were going crazy, and therefore to ensure that cash could get to the Government at a moment when they needed cash to get it out to members of the public, small businesses and others. That is not monetary policy; it is being the market-maker of last resort. This is not a new thought; it is an old thought, one probably hatched during the last crisis.

Thereafter, as the gilt market and the Treasury bond market stabilised, they should have sold those gilts back to the market so that there would now have been less of a monetary overhang. I also think that they stuck with what they call “forward guidance”, which is a confusing term because it is used in two completely different ways—it is probably unproductive to get into that, but it is unfortunate that the same noises mean different things. They stuck to the forward guidance of “Low for long”, or for ever or something, and, “We’re going to run the economy hot”, which was more a thing in the States, to be fair. I thought that both those things were mistakes—they might not have been—so people who thought like me, and there were plenty of us, thought that there should have been less monetary stimulus out there when all these other things happened. But precisely what I would do today I do not know.

Q13 Lord Blackwell: If the Monetary Policy Committee and the Bank of England had the sole objective of keeping inflation at 2%, and then events such as Ukraine and so on happened and imported inflation came in, if they were required just to keep to 2%, that would imply imposing a sufficiently tight squeeze on monetary policy to deflate the domestic

economy sufficiently, and you would have to have falling domestic prices to offset rising import prices, which would have dramatic consequences for living standards and so on. So in practice does there not have to be a dialogue between the Bank and the Government about what is actually a political judgment?

Sir Paul Tucker: The first part of what you say I completely agree with, and the second part I broadly disagree with. On the first part, if it is just a cost shock coming from what are commonly called exogenous forces—things you cannot control—it would be crazy to generate a recession to offset that. The 1997 remit copes with that very well. Brown and Balls did a good job on this. The Bank of England negotiators were Mervyn King, when he was chief economist, and me, as head of monetary assessment and strategy. The statutory regime says that your objective is “price stability and, subject to that, to support the Government’s economic policy”. Actually, that phrasing is not ideal, because that can have anything in it.

The remit, which Parliament told the Treasury to issue to the Bank of England, says—I cannot remember the exact words—that when these cost shocks happen, such as oil prices going through the roof, you should maintain anchored inflation expectations but smooth the volatility of the economy. That absolutely says: do not go generating recessions to offset an OPEC oil price shock. This is not just theory or a nice essay from 1997. In 2010 or 2011—I cannot remember the exact year—we faced a combination of sterling falling and, I think, oil prices increasing, which pushed up headline inflation, the targeted measure of inflation—CPI—to approaching 5%. We said, “This is a one-off.” Actually, there was more than one shock, and I can remember saying in a committee meeting, “We’re going to get into trouble with what the words ‘one-off’ mean”. Nevertheless, Mervyn was tremendously articulate in public, saying, “There isn’t an increase in underlying inflation”.

That is why I started by saying that if 80% of the 8% overshoot is the kind of thing you are talking about, 20% of it is not. Twenty per cent of a small number is a small number. Twenty per cent of a big number can be a big number. If my piece of mental arithmetic gets to roughly 3.5% in terms of regular excess demand, so demand relative to supply, that is a pretty big overshoot. It might not have been possible to foresee it, but I think Select Committees should be asking questions about that and trying to get the Bank to say something about it. It may be possible to say something about it that is explanatory and interesting and even justificatory, but it could be explanatory even if it is not justificatory.

Lord Blackwell: A lesson for other regulators outside financial services would be to try to get the contract, if you like, the remit, defined sufficiently well that, again, they are clear about what they should and should not do in particular.

Sir Paul Tucker: Yes, if they are going to be insulated from day-to-day politics, if they are going to be independent. Most of the other regulators in the UK do not nearly meet those criteria.

Q14 **The Chair:** Coming to the other regulators in the UK, in your experience how successful are parliamentary committees in holding regulators to account, and what concrete effects can Select Committees have on regulators through their scrutiny?

Sir Paul Tucker: A lot is built into the word “accountability”. Actually, accountability is at the very centre of our system of governance, more so than some other countries, which is interesting. Select Committees in both Houses can do perhaps three things that they are good at. One is that, when something goes wrong, they can generate public debate and proposals on lessons, not necessarily minutely about what exactly went wrong but about what should actually be done.

An example of this—I will try to give examples—is the report by the Treasury Committee on Northern Rock, produced by the Select Committee when it was under John McFall. I cannot remember that we agreed with everything in it, but it was terribly good. The process was good, and it got us, among other things, to review what I will crudely call the Bank of England’s lender of last resort facilities, on which there had been a huge and very difficult debate in 2007 inside the Bank. In late 2008, we announced reforms, very much jointly agreed by Mervyn and me, and they were the biggest reforms for a century. I would say that John McFall’s committee made it easier to do that.

Another thing that Select Committees can do—this is not so much about decision-making but about analysing the effects of your decisions, so going back to Lord Blackwell’s question, and the Chair’s—is that even if you are not responsible for doing something or preventing it, you should be open if what you do in your core mandate has effects on that. A classic case of monetary policy over the past 15 years is the effects of QE on distributional issues and inequality. We were kind of edging towards saying something about that, and the Treasury Committee pushed us over the cliff, as it were. Among the major central banks—I am now going beyond the big three or four—the Bank of England was the first to produce a report on the distributional effects of QE. I am sure it was not the best report produced eventually, but it was the first, and that happened because of the Treasury Select Committee.

The other thing that Select Committees can do—they cannot guarantee to be successful in this—is help to bring salience to issues that they think ought to be salient. One of the great things about testifying as an officeholder is that you are really addressing the public through their representatives or the Members of this House, and you have to try—it is not always easy, and I certainly do not want to suggest that I always succeeded—to talk in language that can be understood by an interested member of the public. As part of that, what people on your side of these sessions can do—particularly in the Commons, if I may say so—is to make something salient. That is good. It can be uncomfortable—we used to go back sometimes and say, “Oh”—but we always thought that it was good in the medium run, because it puts what we, not as individuals, are doing into the public arena in ways that interested members of the public can follow.

I think that hearings are the most important thing for sustaining independence. With non-independent regulators, the game is completely different, because there it is about how well an agency has tracked ministerial wishes, which shift about. I have no complaint about them shifting about.

Lord Cromwell: I think you are suggesting that Select Committees can be useful when there is a problem. But what about a more regular review against proper criteria, which in itself is a challenge of course?

Sir Paul Tucker: Let me give you an example. When the energy cap was introduced, quite a good question to have asked—I do not know much about this field, by the way, but I was capable of asking this question of myself—was, “What will happen when there is an oil price shock? What happens when wholesale prices smash through the cap, and what are you going to do?”

Actually, that would have been quite a good question for the policymakers to ask themselves, and to have a contingency plan for; one that was articulated not just in technospeak for members of the industry—maybe they did that; I have no idea—but in the public arena. I think it is a bit more difficult in some of the other fields, and we will come on to this, than it is in monetary policy.

The thing about monetary policy, especially when it is set in terms of interest rates, is that it affects people’s mortgage rates, if they have mortgages, and their savings rates. Therefore, those Select Committee appearances tend to get media coverage. I read the *FT* nearly every day and I follow some of these other areas as best as I can, but I rarely see articles on Select Committee hearings. That should be taken as a sign of failure and a need for some kind of change in the way those hearings are framed and even in the way they are conducted. One should not try to build them up into a great thing every time, but it would be a very bad thing if they never got any publicity at all.

Q15 **Lord Agnew of Oulton:** I am interested in your opening remarks about the interrelation between regulators and the elected legislature and, indeed, Select Committees and their part of that deal. What can we do to make Select Committees better, more demanding of regulators, and, indeed, when recommendations are made to ensure that they are actually implemented or properly debated and explained back to the committee or the wider political environment as to why they have not been? I am new to this, but my experience of Select Committees is that far too often they seem to bounce off when there are deeply entrenched problems. The regulators seem to lock down into defensiveness and not engage properly.

Sir Paul Tucker: I do not follow it closely enough to know whether the latter is true. I can certainly imagine it, and that is a great mistake if they are doing that. It is a strategic mistake because you always need to remember that you are going to be alive the day after tomorrow.

I have two points. I will start with a minor point to get it out of the way. You asked: what happens if the policymakers come along, the regulators come along, and a lot of points are made to them, but they do not pick up those points? Up to a point, this is intrinsic to independence. One of the most important exchanges that I was ever part of in the Treasury Select Committee was towards the end of my time at the Bank of England. George Mudie, who was what the Americans would call the ranking member, the senior Labour member—effectively the deputy chair—said to Mervyn and me something like: “You people come along here and we ask you all sorts of questions and express concerns. You give these eloquent, fancy answers”—I am not sure he said fancy but he did say erudite—“and then you go away and actually it does not make a bit of difference, does it?” I thought that was terrific, for what it is worth, not that it was my place at the time to have any thoughts of that kind. We each gave the same answer, more or less. I think Mervyn said, “You go first” but that might be my imagination. We both said, “Look, first of all we do take your concerns seriously in various ways. We factor them into our thinking. As long as independence, which is in your gift, continues, interest rates and these things are our decision. If it is not going well, you can amend the law. So long as you do not amend the law, and the mandate is clear”—my comments were predicated on that—“then it is for us to reach a view on what to do, having heard everything”.

Now, if the mandate is not clear then it is much more problematic, which we will come on to. The broader thing is that it is not just a question of the regulators but of the committees themselves. We should think about giving the committees stronger, sharper incentives to do their job well. I do not know, does the chair or deputy chair of any of the Select Committees in either House have to make a report to the main House, or whatever it is called, after the session? The reason it works to the extent that it does on monetary policy, and I have thought this for years, is that if the Treasury Select Committee does a poor job in overseeing the Bank of England on the monetary side, then the economic commentators—I could almost name them—are going to say that, directly or indirectly, in their coverage of the session, either the next day or in their weekly column. So the committee itself is under scrutiny. It could not possibly work otherwise. If no one took any notice of the committee hearings, why on earth would the regulators do so, especially if they have independence? I do not know whether committee chairs and deputy chairs together making a joint report to the House of Commons or the House of Lords would sharpen their incentives to try harder. At my junior school you were marked on effort and achievement; the older I have got, the more important I have thought the effort bit is.

Something else that could be done, perhaps—and there are real hazards in this—is if these hearings with Ofgem, Ofcom or whoever are only every six months—they probably should not be more frequent—maybe they should submit 10 pages or 15 pages—not longer than that, although they would want it to be—on what has gone well and what has gone badly and what their priorities are. Their incentive would be to drag this out to 15 pages with 15,000 pages of annexes and to deflect everything. That is

not just wickedness; that is what their machine will encourage them to do.

The final thing, and we will come on to this, is that it is much easier if you have what the Americans call commissions, where there are votes and you see the minority votes. I often thought that Treasury Select Committee hearings on the Bank of England Monetary Policy Committee essentially centred on minority votes. So the governor—in my time Eddie George or Mervyn—would say something, and John McFall or Andrew Tyrie would say to me, “We know you don’t agree with that, Mr Tucker, because you voted differently. So what do you have to say for yourself?” What that does, apart from the element of sport that is inevitably involved on your side of the table, or my old side of the table, is that it enables the journalists, not just those from the *FT* and the *Wall Street Journal* but those from other broadsheets and perhaps local papers for some issues, to see that is where the debate is because it is what people are disagreeing about. It is not a completely reliable thing.

Votes are good, because they guard against groupthink and all that stuff, but they are also good because they help to say, “Well, actually, there is a real disagreement here”. By contrast, in 2007 the great disagreement was about liquidity support and there were not votes on that and actually the issue did not rear its head in public at all.

Q16 **Baroness Bowles of Berkhamsted:** Paul, good to see you. Thank you for the copy of your book, some time ago. Mine has lots of stickers on it, more than yours, but I did not bring it today.

Sir Paul Tucker: The publisher thinks it is more important to own it than to read it, I suspect.

Baroness Bowles of Berkhamsted: I am sorry to disappoint. So far we have talked, for obvious reasons, about monetary policy, which has a certain simplicity about it, if that is not an offensive way to look at it, in that it is high-profile. It has the benefit of being decided by committee and it is therefore possible to interrogate it. There is a lot of what goes on in regulators—you do make this point—that is not interrogatable in that kind of way. If you take the PRA and the FCA, it is actually quite difficult to wheedle your way into understanding their thinking and where they have disagreements, because by the time you even get to a consultation it has been very much thought out and presented and it is quite difficult to get into it.

What we as a Select Committee are trying to do is not to look at the high-profile issues and the mistakes, where Parliament does perform well, but to look at the day to day and how that is working, and to get a better understanding of how decisions and rules are made, particularly in the context of almost everything now going to the PRA and the FCA, but there are other industries as well. So a basic question is: do our Select Committees have sufficient resources to properly scrutinise that day-to-day work of UK regulators? On the other side of that, if the committee structure is strengthened—for example, in the United States it becomes

staff-led; when I went to see committees in the US, the staff there were astonished that I knew stuff, but that is the way that it worked more in Europe and of course works even more so perhaps here—and becomes staff-led, is there a loss of legitimacy?

Lastly, and this would be relevant to the House of Lords, does the fact that we rotate our members, for various and good reasons, mean that we do not serve long enough to get really good at it? Sorry, that is rather a lot of questions.

Sir Paul Tucker: I shall start by reading something from the chairman of the House of Commons Agriculture Committee in 1999. I cannot remember the name of this MP and I deliberately did not name them in the book because the point is not *ad hominem*: "I'm afraid that there simply is not time for select committees to look at each and every one of the [agencies] within their remit ... select committees simply do not have the time and resources to do what they already do, never mind having their own burdens added to." So the answer to your first question—"Are select committees adequately resourced, in some broad nebulous sense, to oversee all the agencies?"—appears to be no, and I think that is completely plausible.

There is then a point that follows from that. As a citizen, which I am now pleased to be, I believe that independent agencies should not be independent if the Select Committees are not resourced to oversee them. Better to have bad policy than tolerably better policy in unelected hands that cannot be overseen. That is what I believe, although lots of people would disagree; in the States, good friends of mine who have served both high up in the Senate and high up in the Executive disagree with that.

On the question of providing more staff, there probably is a need for more of them. They need to be quietly prestigious positions rather than majorly prestigious, but what you described in the States is certainly partly true. I know Members of the Senate from both sides who are pretty expert in the issues that I am equipped to judge—or perhaps you are equipped to judge whether they are expert—but there is no doubt that the staff are the major players. As you know, a senior staffer for a Senate committee chair might be in their mid-50s and their next job may be Chief of Staff in the White House. It is a career path in itself.

The effect is that, were I testifying to you in the Senate or indeed the House, although I have less experience of that, most of you would not yet have turned up and those of you who had asked me a question so far would be about to leave since I had addressed your questions. One effect of that, in contrast to what I saw in the House of Commons Select Committee, is that if I am an office holder, not like now, and I am being pressed hard on something but then Baroness Bowles is timed out and the next question is going to be about something else, in the States the subject changes to whatever the staff of that Senator, or whatever, wanted. In the House of Commons Select Committee, except for very new members of the committee, Members will sometimes abandon the

question that they thought they were going to ask and push me over the ropes, as it were, and that is good.

The other feature of the US system is—and I am saying this so you do not go down this road—currently there a very interesting equilibrium where many of the serving members on the Securities and Exchange Commission and the other regulators are former Senate staffers. The president has so many people to nominate and get confirmed that the equilibrium has been that, for the lesser but nevertheless big jobs, some of them will be the staffers of the committees that oversee the agency. So the next MPC or Ofcom members would be coming from the staff of the Select Committee. I know some of these people and admire some of them and like many of them, but that is not a good system. You need somehow—and I do not know how to do this—to enhance the resources that support the Select Committees so that the agriculture chair does not feel that she or he has to say that, without turning the staff into where the action is.

I could say something about the PRA and the FPC. In passing, I think the lack of voting is a problem, and that is partly my fault. Perhaps I shall save that for later.

Q17 **Baroness Donaghy:** Actually the Chair asked my question earlier—that is, “How important is it for regulators to be given clear, consistent objectives?” To what extent has the UK managed to do that successfully with its regulators? We are just about to embark on a study of Ofwat and are already finding the grey murky areas between the Environment Agency and Ofwat regarding the fact that we still have unacceptable amounts of sewage poured into our rivers. It is quite clear that the consumer is not getting anything out of the exercise, and that is even before we have started the study. Do you think that our approach of rank amateurism is successful?

Sir Paul Tucker: I do not know if it is rank amateurism. It is incompetent, but I do not know whether it is deliberately or accidentally so. To expand a bit on the answer I gave earlier to the Chair about clear mandates, for an independent agency—it is different for non-independent agencies, and I will say something about that in a second—I think you want what fancy people like me call lexicographic objectives, so there is one thing and then “Subject to that..” You want the primary activity to be monitorable by a penumbra of experts, including people on Select Committees, who are a bridge to the outside world so that interested members of the public can tune in.

There are two points there: do not have multiple objectives and do not have vague objectives. I am going to read out what the objectives of the Financial Conduct Authority were when I published the book, and then I am going to amplify that about the SEC because I know a bit more about it. The first objective was “securing an appropriate degree of protection for consumers”. Even if that stood on its own, the question is how much protection is enough. One could have very different views on that according to all sorts of factors—political views of the world or more

scientific ones. The second was “protecting and enhancing the integrity of the UK financial system”. Obviously “integrity” would cover both honesty, which is important, and stability, which is also important. The last was “promoting effective competition in the interests of consumers”. That cannot be the same as the first, as lawyers would say, because otherwise it would not be there—but which doctrine of effective competition?

In the States, the objectives of the SEC are the protection of investors, efficiency of markets and promoting capital formation. The last was introduced under Reagan, and it is interesting that there is nothing of that flavour here—that capital markets might actually be important for the supply side of the economy. I do not even know whether that was debated when they agreed these objectives.

Now imagine that one of you—or me, for that matter—is appointed to be the chief executive or chair of this outfit. Which objective are you going to prioritise? What happens in the States when the Administration changes is that the chair flips, under an informal norm, from being a Republican chair last time to being a Democrat chair, and the weight given by the SEC between capital formation, market efficiency and investor protection shifts somewhat.

The other effect of this is that when something has gone wrong and I come along to testify, you are all very keen on, let us say, consumer protection, which after all is a good thing. But then the economy falls behind other economies, particularly on investment, and something goes wrong on that, I come back 18 months later and—well, Select Committees never shout, but you complain that I have not been prioritising investment enough, and you brief papers and give speeches and all that stuff, which is obvious.

What I have never understood about the agencies here, other than the Bank of England, is why they do not testify saying, “Well, this is hopeless for us. If independence is a solution to a commitment problem, you have to commit to which of these three you think is important. We never have the resources to do them all adequately”—which seems inevitable to me—“so whatever goes wrong, you are going to decide ex post which one we should have allocated our resources to”. That is not the kind of job a sane person would want, is it? This is a very big problem. It is completely different from what I call executive agencies, which Ministers are allowed to chop and change, and you go to the ballot box.

Q18 Lord Sharkey: Morning, Paul. I just wanted to follow that by asking about steering—strategic policy statements, the strategic steer—which in one sense looks as though it was invented to try to resolve some of the problems you have just outlined. What is your view about the use of the strategic steer?

Sir Paul Tucker: Thank you for the question. This book was written five years ago, so I am not completely up to date. When I first heard about these strategic steers, I thought, “Oh, they are trying to replicate the kind of remit the Bank of England has on the monetary side; that is a

good idea". But then I talked to a number of people about it and there was one man, whose name I forget, who had researched this, and actually they are tremendously long. Someone said to me, I think reliably but I cannot be sure: "They get passed around Whitehall and every department adds its little bit". Imagine the Treasury passing the MPC remit around Whitehall.

There is something else I was struck by; this is a slightly different point but I was amazed by it. I think the Competition and Markets Authority is incredibly important in a market economy. Whether we should have a market economy is for Parliament, but if we have one, the competition authority is incredibly important. In my time, its remit was signed by a junior Minister. I think we would have been very concerned—I think Mervyn would agree with this—if a junior Minister signed the remit for the MPC, however much we admired the relevant junior Minister. You need that kind of political authority.

The strategic steers, on my understanding, are a good idea but were screwed up. They are perhaps harder to do well—to go back to the previous question—if the objectives are vague to begin with, because then, in terms of the Whitehall wish list thing, you can actually start adding in everything. The Bank of England has not been immune from this. The Financial Policy Committee—I would say this because it was partly my idea—is tremendously important, because financial stability is tremendously important. The length of its remit has doubled since it was created. There are nearly three times the number of trade-offs and qualifications. I have not studied this; I am relying on a blog by something called Macroprudential Matters, which I think is pretty reliable.

My response to that is that my default assumption, although perhaps not my conclusion if I looked into it, would be: that is what you would do if you wanted to quietly dilute the potency of the FPC and quietly dilute the effectiveness of its independence. Coming back to Lord Agnew's question about what committees can do, they could scrutinise more these remits and strategic steers. We had this view, almost never spoken even to each other, that Parliament protects you from the Executive and the Executive sometimes protects you from Parliament. Parliament is protecting the country from the agency. That is not a bad place to be. This business of just expanding strategic remits, with lots and lots of "have regard to" and "do this and do that"—if Ministers want it back, let them take it back. That is what I feel as a citizen.

Q19 **Baroness Bowles of Berkhamsted:** To take this back to the FCA—yes, it has been given a lot of objectives but is that not to try to establish where regulatory perimeters are? This is constantly the problem for the FCA and for politicians: there is no definition of what is in and what is out, and from time to time there is anger over things being deemed outside the regulatory perimeter—the whole GRG thing, for example. Is it right that that perimeter—

Sir Paul Tucker: Was the GRG thing about the issue of bonds?

Baroness Bowles of Berkhamsted: The GRG thing was where SMEs were put into a special unit and basically asset stripped. Because it was SME loans, it did not come under the remit of the FCA at that time in how it had interpreted it. Whenever a disaster is investigated, the regulatory perimeter often comes into it. A broad remit given to a regulator to interpret still ends up with rules and things that are outside it, which then surprise the citizen.

Sir Paul Tucker: I think the question of the remit is actually separable from the question of the objectives. I will come back to the perimeter shortly but, wherever it is, what are the objectives that you have for the people within it? The case that I was thinking of is something that issued a lot of bonds and ran a credit business and everyone said it was beyond the perimeter on the descriptions of it in the newspaper. Going back to when I started, the legislation may have changed but from the early 1980s to the mid-1990s, it would have been a bank, a deposit taker, because it was taking sums of money repeatedly and investing them in loans. That is not a point that came up in the review about it; I do not know why, maybe the law has changed.

The perimeter thing is obviously important. Something that we managed to get into the legislation on the FPC—the Financial Policy Committee—is that it has a responsibility to make recommendations to the Treasury on when the perimeter should be changed. Actually, I think it should have made recommendations on shadow banking, although I may be completely wrong about that. Since it has not, if something goes wrong with shadow banking that affects financial stability, it did not exercise its statutory right and responsibility to make that recommendation. I do not know whether the FCA has a power like that, but you need a set of incentives to monitor it in-house.

I do not know whether it still does it, but certainly when I was there we set up a process whereby every year the FPC would have a discussion on the perimeter, and its conclusions on that would be published, because I wanted to nail into the ground the need to think about what it should recommend to the Treasury. You need to keep it simple but flexible.

Q20 **Lord Blackwell:** I would like to move us on to the culture of regulators. I am aware that most of your experience has been with financial regulators but there is a general concern that regulators tend to have a very conservative, risk-averse culture. They tend not to support innovation. They do not necessarily think about how the industry needs to adapt to become competitive. That may be partly because a lot of the regulators—not in financial services but in other industries—were established in the 1980s, when their job was to regulate established monopolies. They were not envisaged to be about dynamic industries. It may also be because Select Committees, when regulators do attend them, always want to jump on failures, things that have gone wrong, and therefore if you want to keep safe you avoid doing anything that might be the right thing to do but might expose you to risk. Do you have any views on whether this is a problem in the UK, why it might be and what can be done about it?

Sir Paul Tucker: I have three thoughts. The first is something that would almost need to be embraced by the chairs of Select Committees in both Houses. I will give you an example. You are plainly right that people worry about things going wrong and the world not falling down upon them and, even more importantly, their institutions. The classic example of this, as you and some other members will remember, is that in the 1990s BCCI failed, and there was quite rightly a hell of a to-do about that. The then governor—I was his Private Secretary—Robin Leigh-Pemberton, certainly thought that the Bank had fallen down on the job and that it deserved criticism and that there needed to be some reforms. But during the same period he personally avoided the failure of Midland Bank.

Sitting in the next room, Eddie George handled the, if you like, second secondary banking crisis—the small banks crisis—as an absolute masterclass in crisis management. He got no credit for that. Whitehall mandarins wandered round town saying Eddie had overreacted, creating a culture where in 2007 they got fed up when somebody underreacted—be careful what you wish for. And the Midland thing had to be kept quiet. I was privileged to give the eulogy in Canterbury Cathedral for Robin Leigh-Pemberton. I watched what he did with Midland Bank and it was staggering. It took enormous courage and John Major privately backed him, but since it could not be talked about, there was no credit for it.

There is a problem of regulators being worried about what will happen when things go wrong. The solution is for them to embrace as much transparency as possible and—without ever bragging about it, for God's sake—talk about the things that they have done, including their achievements, which is easier to do if they have clear objectives.

Secondly, around innovation, for independent agencies there should be innovation within the framework that they have. In the digital world, where I think of proper stablecoins as quasi banks and algorithmic stablecoins as unstable and probably worse than some of the crypto things, the question is: how much disclosure do you want to go to consumers? If it is a Ponzi scheme, some of them will lose some money. The only difficult question there is: when is it big enough that it is actually some kind of financial stability problem? But you need not choke off the innovation. Actually, Andrew Bailey has been quite clear that he thinks that certain things are going to go wrong, and he may be proven right, but I do not think the Bank is trying to stop it.

There is a big issue around disclosure here. Is relying on disclosure enough? Then you get to the question, especially when you have spent part or perhaps the core of your career as a political advisor: how much do the Prime Minister and the Cabinet want to rely on protecting consumers via disclosure, and how much by vetting various products? I do not think that is a question ultimately for an unelected person. I think unelected people can have views on it, but if you are going to say to people: "Caveat emptor, but the regulator is going to make absolutely sure that you are told, and if you are not told, the people who obfuscate

it can be punished in some way”, that is very different from saying, “We are going to approve investment products”.

I was an ex officio member of the old FSA board when Adair was chair, and it wanted to move after the crisis to approving investment products. I said, “You’ve got to go to the Select Committee and the Prime Minister on this. Even if the lawyers are advising us that this is within our powers, it is such a big change that it is not for us to decide”. That was a pretty unpopular view, frankly, in the FSA board. I thought that that meant that the members—not Adair personally, he did actually write a letter—had not embraced who they were. “What advice would you have given to the Prime Minister who you served about that?” is an important question. So I think this innovation thing should not be left just to unelected officials. How much risk society should take is ultimately for elected officials, advised partly by your House.

Lord Blackwell: There is an issue, is there not, that when the remit—the mandate—is narrowly defined, and tends to be defined by politicians, again in a way that emphasises safety, the protection of consumers in the case of the FCA, the protection of the stability of the system in the case of the PRA, and the same for some of the other regulators, there inevitably are trade-offs, where some things that might be desirable conflict with the primary objective of “We must not do anything that might put consumers at risk”.

Sir Paul Tucker: That is not true of the PRA, and I know this because I am significantly responsible for the provisions of the law, which I have forgotten in detail, that have the effect that it is okay if people fail as long as that does not undermine the whole system. What we wanted to get to was a law, bestowed on us by Parliament, that would tolerate failure. You then need to have good systems for coping with failure. I would say that the objectives of the FCA do not provide any steer at all on that. I think the objectives of the PRA absolutely do. If it is interpreting them in a different way, I would regret that.

Q21 **Lord Reay:** Paul, can I ask you about your thoughts on the governance of regulators in the UK? Is too much power concentrated in the hands of chief executives and should more regulators have a committee-based approach in the manner of the Bank of England policy committees?

Sir Paul Tucker: Yes and yes. It started in the 1990s, partly in the Treasury, partly elsewhere, among officials very taken with the reforms in New Zealand, which became known as the new public management, which found an academic home, partly, at the LSE. The idea was that we could make these bodies, these parts of government, a bit more like public limited companies. This was a very false move. I have seen public companies at a distance and I have seen them closer up, and the average board proceeds on the basis that you back or you sack your CEO.

Actually, I saw this with the Court of the Bank of England in 2007, when some of the members of the court—Paul Myners, Amelia Fawcett—wanted a debate in court about the disagreement going on between Mervyn on

the one side and me and some others on the other side. The then chair of court, a good man, did not allow that debate to happen. I think that was because the people concerned had internalised the idea that we needed to back the governor. It is not like a company. First, sacking the governor is above the pay grade of the chair of the Court of the Bank of England—by some considerable distance—and, secondly, what is at stake is greater. Companies can fail or underperform and the market will produce some alternatives. I think this is really bad design.

In researching my book—of course I have lots of friends who served on the boards of economic regulators and I talked to some of them—I asked: “Are you involved in policy or are you just an oversight body?” They said, “No, we’re involved in policy. It’s not just the chief executive”. Their answer to your question would be: no, it is not just the chief executive. I said, “Did you have a confirmation hearing?” “No”. “Do you vote on rules?” “No”. “Do you give speeches explaining our position on policy?” “No”. “Do you testify on your positions on policy?” “No, the chief executive does that, with the chair”. I then phoned up a Minister, a Secretary of State whom I knew, who had one of these bodies underneath them at the time. I asked: “Who is important in such and such—one of the Ofs?” and they named the chief executive. I prodded them a bit over the phone, and they said the chief executive.

The beauty of the Bank of England monetary policy system is that you have nine people and they have a discussion, and for the internals—I do not know whether this system has gone wrong—their vote is theirs, hers or his. In my time there was not much groupthink in the Bank of England. I have referred repeatedly to a massive disagreement. The court was terribly good at making the Bank careful with costs, on the integrity of its processes on operational risk and all those things. But if you are going to have boards that oversee things—truly oversee the substance—they need to be a bit expert in them.

I was approached by a headhunter—normally these things mean nothing—who asked whether I was interested in being the chair of the CMA. I said, “That’s a fantastically important job and I am very interested in that, but you should not remotely think about me. I know quite a bit about it but not nearly enough”. The headhunter replied, “But you don’t have to be expert”, and I said, “You have to know sufficient for when the executive underneath you are egregiously wrong”. So that is the wrong mode

Alternatively, if they are going to be co-policymakers—involved in making rules and so on—that is a full-time, or nearly full-time, job. It is not something where you roll up once or even twice a month for half a day. You have to be thinking about it nearly all of the time; frankly, it has to consume your life. Perhaps then there would not be sewage. On the sewage thing, what have the votes been on the Ofwat board on doing something about sewage?

The Chair: We should be asking these questions.

Sir Paul Tucker: Yes—so I think that the UK system is dreadful and not fit for purpose. It was a delusion to think that parts of the public sector are like public limited companies. Ultimately, it is to do with failure: public limited companies can fail without the fabric of the whole thing falling apart. On the whole, regulatory agencies do not fail, go into bankruptcy or disappear; they just underperform, or sometimes overperform.

Lord Reay: On your comment on groupthink, the B of E—the MPC—has recently been criticised by some for groupthink in its failure to anticipate the effect that excessively loose monetary policy would have on inflation, in contrast to Switzerland, for example.

Sir Paul Tucker: Switzerland's case is a bit different because it has had a policy that is essentially currency based, given the euro area. I am not at all sure that there has been group think in the MPC, but, if there has, the cause will lie in this forward guidance thing, where you predict what you will do even though you do not know what you will do. There is no point in doing that unless a sizeable majority is behind the statement of what you are going to do over the next year or two. Once you have fallen into that habit, the "it's my vote" culture starts to get eroded.

I was never in love with forward guidance, but I thought that it was an okay thing to do for a short while in 2013—well, I left then. It had not been done before 2013, if I can put it that way, and, even if it worked on its own terms, it was a mistake to stick to it, including at the Federal Reserve. I do not know whether it leads to groupthink, but I can see how it would reduce this sense of "my vote is mine".

Someone from the Bank of England gave a speech this week, I think, saying that they pushed for interest rate rises last year. I asked a friend to check what their votes had been, and they were in line with the core of the committee all of the time. In the committee that I was secretary to—just a mute scribe—I remember Willem Buiter, Charles Goodhart and Alan Budd were disagreeing, and, actually, Mervyn voted against Eddie during that period. That is what "one person one vote" means: deputy governors voting against the governor. In my time, Charlie Bean and I both voted differently from Mervyn. Someone asked me about that, and I said, "Well, he is wrong. We'll find out". He thought that he was right; that is how it is meant to work.

Q22 **Lord Cromwell:** Can we try to grip this slippery independence issue a little more? If we think that the purpose of regulators who are unelected but have delegated authority is to act as independent and consistent monitors and guardians of the activities in their sector, that sector will in practice be subject to transitory government policy choices and shifting objectives over time, which will impact what it can do. So should regulators be making independent choices on contentious policy matters, or should they simply be looking to government for decision-making? If the answer is the former, they are quasi-policymakers in their own right, and even the appointment of the membership becomes political. If it is the latter, how can they be independent of guidance from possibly less

expert—you underlined the importance of expertise—or indeed inconsistent government directions?

Sir Paul Tucker: I broadly agree. The case for independence means being insulated from day-to-day politics. Why would you want to insulate? It is because you want to commit to some kind of objective. It is not sustainable unless there is a consensus across Parliament, articulated or not. You want to commit to that, and you know that, if you keep it in elected hands, however sincere they are, they will change course. I have no doubt whatever that Margaret Thatcher was sincere about low inflation, but she could never bring herself to stick to a low-inflation objective. So we lurched around from one type of monetary targeting to another.

The same is true in other fields. When the utilities were privatised—Lord Blackwell referred to this—the big question was around the fact that they need to know what the regime will be for a long while, so that they do not abuse their powers but know that they can plan very long payback periods for any investment, on the basis of a stable regime. That needs to have cross-party support and broad support outside. It also needs a monitorable objective.

The way that I am describing it is the way that was implicit in your question: “This does not fit with being a policy entrepreneur. What else do I want to fix?” There was one discussion during the financial crisis, when a terrible train thing was going on. Mervyn and I were having a meeting, perhaps with Charlie there, and Andrew, I think, said, “We’d run the railways better than these people”. Mervyn and I said, almost in unison, “We would do almost everything better, but that would be a terrible idea”—for the reasons that I mentioned.

To go off-piste, whether it is in relation to climate change or inequality, why do we have Parliament, for goodness’ sake, going back to the 13th century? It is because there are big distributional issues, and we want them decided by representatives. If you put that in unelected hands—Christine Lagarde will experience this at the ECB—how much leaning against climate change is enough? People on one side of the argument will say, “Almost anything is not enough”, while people on the other side will say, “Almost anything is too much”. That is why we vote for people here, thank God.

We are saying to people that we are clear that we want price stability and a resilient financial system. That can be delegated, as can the utility thing, although that perhaps needs a bit more thought about exactly how it is framed.

Lord Cromwell: Can I clarify something? There is a sort of dialectic or continuum here between independent bodies exercising their authority and elected representatives telling them what to do. You seem to be more towards the end that says that regulators carry out the instructions of the elected authority, rather than making decisions in their own right.

Sir Paul Tucker: It is about objectives. I keep coming back to central banking, not because it is what I happened to do but because it is the one case, or one of very few cases, in the UK where the objective is fairly precise. They decide what interest rates are and how much QE to do, but they are always constrained by the need to achieve a 2% inflation target and not cause too much volatility in the economy. It is nothing to do with politicians. I turned up for an MPC meeting one morning, when Labour was in power, and some of the people were a bit flustered, saying, "Did you hear Ed Balls on the radio saying what we should do?". I said, "You should never listen to the radio on the mornings of MPC meetings. It does not matter what he says". You have to be like that.

Lord Cromwell: But do you accept that many of the other regulators that we may speak to will have less easily defined objectives, and therefore there is a lot more interference potential?

Sir Paul Tucker: That is a problem. To the extent that you cannot define it, I am not for their independence. The thing that I am most against, as a citizen rather than a former central banker, is a kind of phoney independence where the mandarins and the Ministers hide behind the phrase, "It's all independent"—except maybe it isn't. You either have rule by unelected power or you have rule that you cannot quite see, where a Potemkin ruler is being shown to you but the real strings are being pulled somewhere else. Lord Blackwell will know a great deal more about this than I, but I suspect it is possible to frame objectives for the utility regulators that would get around this, provided that there is a consensus around economic efficiency. The same goes for the CMA.

Q23 **Lord Sharkey:** I would like to continue on the notion of independence. In your book and your New City Agenda lecture you talked about three markers for independence. The first is that the policymakers have control over their instruments. The second is that they have job security—not necessarily tenure for life, but job security. The third is that they have budgetary autonomy. Given those markers, or criteria, how many of the major regulators in the UK do you think would qualify as independent?

Sir Paul Tucker: Formally, quite a lot of them would. Formally, the FCA is probably more independent than the Bank of England because it has a high degree of budgetary independence. The Bank currently has to have its budget approved every five years. I personally would have preferred that to have been seven, but five is okay.

By the way, they are planning on shifting it to a system where the budget is approved every year. That is a very interesting issue: the very fact that that is being proposed means that the Bank of England has acquiesced to it being floated in public. I cannot imagine that under Eddie or Mervyn.

There is some very complicated reason about cash ratio deposits but—like Schleswig Holstein (or whatever it was called), I am one of the three people in the world who understand it—

Lord Sharkey: Who know the answer, yes.

Sir Paul Tucker: ... that is not sufficient reason to move to annual approvals—

Lord Sharkey: Of the others, one of them is dead and the other is—

Sir Paul Tucker: —so that is likely to be a ruse. The question, and this inevitably goes around the same territory, is whether we have some regulators that are formally independent but, in my view, should not be because their objectives are too loose. That can lead to one of two things: what I regard as illegitimate rule by unelected people or, if they recognise that, trotting along and seeing the mandarins and the Ministers for a steer. I think that needs to be fixed.

By the way, none of these things needs to be absolute. On the question of control over your instruments, in a constitutional democracy I see no problem with Parliament bestowing a power on the Secretary of State to intervene and overrule, provided that that is done publicly and disclosed to Parliament and that people are held accountable in Parliament for exercising those override powers. The Treasury has powers to suspend independence and to override the Bank. There would be quite a clatter if it did so but I do not object to that being there; in fact I can think of circumstances where I would far rather independence be suspended than everyone pretend that things were normal, although I am not saying for a second that we have been in those circumstances.

So you can qualify each of these things but you have to have them. Job security is tremendously important. I shall give an example of where things went wrong. At the FCA, whatever I think about it, Martin Wheatley was suddenly defenestrated—actually he chose to throw himself off the top of the building, which one would not expect normal people to do—and the leader in the *FT* a few days later was about whether he had done a good or bad job. I do not know the answer to that, but what the leader should have been about is, “How come the chief executive of an independent agency can be defenestrated?”

The only reason why I am giving that example is not to bring Martin, George Osborne and all those people into it; it is because I think this country is more relaxed and casual about these matters than the other major democracies that I studied in my book. The *FT* is a fine organ but it thought the question was about the substance. It was not; it was about small “c” constitutional norms. What does it mean to have an independent agency if when you are fed up with the chief executive—perhaps for good reason—he or she has to leave early?

Lord Sharkey: I find it quite difficult to have the notion of strategic steers alongside the notion of real independence. Is it not the case that strategic steers are really badly disguised government instructions to the regulators?

Sir Paul Tucker: In the big picture, I think you are basically right. Earlier I referred to how the Financial Policy Committee’s remit doubled in length after 2013-14, and again recently, and how some of the “Ofs”

have these copious strategic steers, but that is not the complete thought; the other aspect is how frequently they change. One of the things that I think worked really well with the MPC is that Brown and Balls introduced its remit and it did not change. In 2013 the remit said, "You're authorised to do forward guidance". One of my colleagues—not the governor—was very fed up about this and said "That doesn't need to be there. Of course we are empowered to do forward guidance if we want to, but this is effectively telling us to do forward guidance."

This goes back to our very first question today: that issue did not come up at all in the Select Committees. The Bank was hardly going to volunteer it because the incoming governor, quite reasonably, liked forward guidance very much. I have no criticism of that, but no one asked the Treasury, "What were you doing saying that they should do forward guidance? Either you delegated this with the objective or you did not." These matters are very subtle. Whether it is frequent changes to the strategic steers or substantive redirection saying "Please do this", the Select Committees could do a better job of being on that. However, and this goes back to something I said earlier, they need to be under incentives to do so rather than letting it pass. They need to feel, "If I don't ask the Treasury, or the Ministry of Energy or whatever it's called today, about that then the relevant columnist in the *Times*, the *FT* or some other broadsheet is going to write a piece saying 'There was an extraordinary hearing in Parliament today. There was only one issue that needed to be asked and no one asked it'."

Q24 Lord Agnew of Oulton: To move back to some international comparisons, you have written that France has made some quite dramatic changes to the number of its independent regulatory agencies, and you have made your views clear on proper independence, but could we learn any other lessons from what France has done in its review of regulators over the last few years?

Sir Paul Tucker: I do not trivialise this. One of the nice things in life as you get older is to have one's prejudices challenged. When I went to Paris to see various people in the Conseil d'Etat and all sorts of other agencies, I did not really expect to find a place where these issues were taken more seriously, but I did. The narrative is that the senate, which is the weaker of the two assemblies, had a committee that produced a very critical report on the multiplication of independent agencies, and it did not just drop into nothing. A while later the assembly, no doubt reflecting a steer from the palace, introduced legislation that introduced criteria for independence. That is what led to the reduction in number, I think from around 40 to around 25, as well as a kind of model structure.

Cases on the notion of independence in general have gone to both the Conseil d'Etat, which is in effect the final court of appeal for administrative laws—forgive me if I am teaching you to suck eggs—and to the constitutional court, because there were various questions about whether under the French constitution you could delegate rulemaking to these bodies. I left thinking that—while of course our constitution is different so the issues manifest themselves in different ways, and I am

sure the solutions to them look different—I had not encountered anything like that here.

In Germany they have something even worse: under the constitution (the Basic Law), there cannot really be any delegation at all and therefore there is not—except that I can absolutely promise you there is. (The Bundesbank is different.) So they have a problem of the de jure not matching the de facto. When you are dealing with BaFin, BaFin is not allowed to be a norm-making institution under the Basic Law. It is subject to both types of scrutiny from the Ministry of Finance. When things went wrong, it was the head of BaFin who went, because under Mr Sanio BaFin was de facto operating independently from the Ministry of Finance.

So Germany has a worse problem than us but France is being more serious about trying to recognise the issues that it faces and do something about it. I think that reflects not all this Cartesian-type stuff but a slightly greater taste for the general rather than the particular. If there are issues here, although I may be wrong that there are, then it is not good enough to go separately through this Ofwat problem with sewage, that Ofgem problem with the energy cap or an FCA problem; they may all be idiosyncratic problems—one should always keep one's mind open to that—but maybe there is actually an underlying problem of design. France concluded that there was, and tried to do something about it. I am not in a position to say how well that worked because it was happening just as my book went to print.

Lord Agnew of Oulton: That is what I was going to ask. Is there any feedback on whether it has had a beneficial impact?

Sir Paul Tucker: I do not know. In my second career I have now moved on to a different book, which is coming out this autumn. However, I would be very surprised if there were not studies in France, possibly from the Parliament itself. People in the senate were so worked up about it that, unless they have moved on personally, it would be slightly surprising if they had not studied it. I found the people in the Conseil D'Etat fascinating to talk to about all this.

Q25 **Lord Sharkey:** We have talked for an hour and a half without mentioning Brexit at all. I ought to put that right by asking you: given Brexit, does anything need to change fundamentally about the scrutiny of the regulators? I say that in the context chiefly of financial regulators because of the huge transfer of power that is heading in our direction.

Sir Paul Tucker: I do not know the answer, partly because I have not thought about it very much. I can maybe help a little by outlining what I think the problem is. At the moment—or, rather, this is what has happened in the recent past—the main regulations, particularly on the prudential side, were decided in the EU via the Council of Ministers and the European Parliament, giving them some kind of democratic stamp, but checked by the democratic considerations of all the other member states around the room. So you had some input and democracy but it was not terribly short-termist because the member states tended to

cancel each other out, if I can put it like that. That might be a reason for leaving or staying—who knows? But now that is not the case. If they give it all to me, as I used to be, or to whoever now is me, whoever he or she is, they are not elected, and that is a big change.

In the early to mid-1980s before the EU started producing rulebooks of this kind, which happened in the late 1980s, the way that the Bank of England used to do things and the way that prudential supervision worked was that the statute—the Banking Act 1979 and the Banking Act 1987—said that to be an authorised bank you needed to be run by fit and proper people, there needed to be four eyes, you needed to be prudent and you needed to have capital adequacy. There was no doubt a fifth one, such as “You can’t have loads of interconnections”. The Bank wrote—actually I wrote some of these things as a junior scribe, or rather I wrote drafts of them that people rewrote—guidance on how we would think about capital adequacy.

I give that example because what preceded Basel—and Basel was based on the then Bank of England system—was not a rule; it was a document published by the Bank of England that said, “This is how we are going to assess capital adequacy”. Its decisions were in the form of “We will subject you to restrictions” or, for the smaller banks, “We will revoke your licence to operate”, and that was challengeable by judicial review. We were always very sensitive to being overturned on process, which we never were, and my bosses were a bit less bothered about being overturned on substance because you could let the tribunal take the responsibility for the failure of that bank.

That was a world where legally binding norms were not passed by unelected people but unelected people issued guidance as to how they would try to interpret and apply the criteria in the statute, and that was checked through the process of judicial review. What is now being suggested, because the world has moved on—I do not think it would be very straightforward to go back to that world, but there I emphasise the word “very”—is that they should be writing the rules. In the US this is managed by the Fed, which passes the rules as laws, being subject to the Administrative Procedures Act, which prescribes in law precisely how that consultation should work. If you have breached that Act in your rule-making process then the rule is void, voidable or both, depending on the circumstances.

Part of me thinks that if we are going to give law-making powers to unelected officials then we will need some kind of framework for precisely how they consult. That is as far as I get, not least because if you asked me whether the Administrative Procedures Act was a success or a failure, I would say both. So this is easy to mess up. Still, I think this measure is a big deal. It is not going back to what we had before. What we had before was the application of laws passed by Parliament and subject to challenge by judicial review. That is not the same thing as writing legally binding rulebooks.

Lord Sharkey: As things stand, it is likely that Parliament has no role in

that.

Sir Paul Tucker: If it stays like that, at the very least the rational thing for any of the regulators to do is to push as many of the big questions in front of Select Committees as possible. We did this with ring-fencing, by the way, so it is not true that it has not happened before. Vickers' ring-fencing was introduced and everyone said it was very good (although some people now say it is very bad). The Treasury initially wanted us to do all the heavy lifting in terms of the substance but we said, "No. Other than saying 'There shall be ring-fencing', you haven't done anything. You have to flesh this out. We can then add some details." The fact that there is secondary legislation on that is a response, in personality terms, to Mervyn and me but I think Eddie and George Blunden would have said the same thing: "No, you must decide the regime. This is a big thing that no other country is doing. What do you want it to look like? We can then do some tertiary stuff." But that is not the approach, as I understand it, that they are taking with this.

To the extent that this is about the financial services industry, it is in the Bank's and the FCA's interests to find ways of not substituting themselves for Parliament or, if they are forced to do so, showing that they do not think it is a great idea. This is not just back covering. Of course there is an element of that, but if you truly believe it then the back covering is an incidental part of it rather than what motivates you. What should motivate them is the fact that they were not elected.

Lord Sharkey: I would add that on the whole Parliament is allergic to being seen as a consultee in these matters.

Sir Paul Tucker: What I would say to the other place about that is, "If you give all the powers to us, that's where you're going to find yourselves. You could keep the powers for yourselves or give them to the Executive." That is the problem, and it is what has happened in the States. The States is governed by unelected people in regulatory agencies and the Supreme Court, which is not exactly consistent with the values that animate a democratic republic.

Q26 **Baroness Donaghy:** I want to ask a bit more about consumers and regulators. This is a personal view but I think the consumer lobby is very weak in this country. It is quite easy for regulators to say that they are looking after consumers, whether it is about affordability, safety or the security of supply, but to what extent do you think the regulators in this country pay sufficient attention to the needs of consumers?

Sir Paul Tucker: I do not know. My other answers may have been silly but this is the first question where I do not quite know what to say, except that the issue of how far to protect consumers is a political question. If I think about investor protection, which I know something about because I helped to design the Hong Kong system a long time ago—it worked very well, although probably not any longer—I think, "How far do you want to protect investors and consumers?" That feels like a decision that should not be left to an unelected person but one that

some elected person should decide. How do you then frame that in such a way that clear guidance or constraints are imposed on the unelected regulator?

I think that is a terribly hard question for politicians to answer. When things go wrong, we as members of the public, whether regarding Grenfell Tower, financial scandals or anything else, naturally think, "That damn well shouldn't have happened and it's a disgrace". The challenge is that you cannot rule out all failure—although plainly you should rule things like Grenfell Tower, which is why I mentioned it as an example; that is a clear case where no reasonable person would think that flammable cladding seemed like a good idea on a tower block—but there are other matters where it is not so clear, so how can the politicians stick to their view? I think this is a massive question, and I do not know what the answer is.

Q27 Lord Blackwell: I would like to ask about the other side of the industry equation, which is engagement and taking account of the views of the industry being regulated. Clearly regulators need to understand the industry but equally you do not want to get to a situation where they have been captured by the industry that they are regulating. In financial services, I am not sure that there is a view that the Practitioners Council and so on play a particularly good or strong role. Are there any principles that you think we ought to take account of in the way that regulators should relate to the industry that they are regulating?

Sir Paul Tucker: I was a sceptic of the practitioner and consumer councils, which I saw fairly regularly when I was an ex officio independent director at the FSA. The Practitioners Council tried to slightly lord it over the chief executive of the FSA; the CEO travelled to another building and sat outside for a while, and I thought, "We're not going to do this when it comes back to the Bank of England".

I talked once to a Chancellor of the Exchequer about consumer panels, and this person was of the view that many elected MPs were better tuned in to what consumers were thinking than the people representing them on the consumer panels. As I say in my book, and this is kind of a funny story but quite serious, I believe it to be true that quite a few members—certainly more than one—sitting on the earliest FSA consumer panel had earlier in life been members of the SWP, which in a democracy like ours is a perfectly legal party and all that, but I am not sure that one would necessarily think of it as representative of the consumer interest or even a significant portion of it.

The other thing, about practitioners—I will say something more constructive in a second—is that, unless this has changed a lot in the past decade or so, the industry tends to be inconsistent about what it wants. On any particular issue, it wants certainty and it wants a rule. CEOs and chairs say that to the governor and the deputy governor, and when you are a bit junior they certainly say it to you; they press it very hard—"We need certainty in this". Then exactly the same people come along a

month or so later, or perhaps even within a week, saying, "The rulebook is ridiculous. It's vast."

On the whole, and we are now definitely drawing on my experience, I thought talking to practitioners was quite a good way of finding out how the world worked, how markets worked and how bits of the plumbing worked, but to be frank I did not think they were always very good at understanding their own medium-term to long-term interests, and I am pretty sure that Eddie George—God rest his soul, he was a really great central banker—and George Blunden thought the same.

Constructively, in consulting with industry you should be transparent and clear. Your consultative papers should be capable of being read by a CEO, not just by the ever expanding regulatory affairs department, the compliance department or the legal counsel. When the PRA came back—actually this was before then, before Second Reading—Mervyn and I said we wanted to issue a document on how we were going to approach prudential supervision, which was going to be very different (although I am not sure it is very different now). We had key people ready to do that, and we talked about the length. We said, "We want it to be very short." They said, "What, 50, 60, 70 pages?" We said no, and we frowned a bit in a Bank of England kind of way. I said "Twenty" and Mervyn said "Steady on, Paul", which I thought was rather good.

What we wanted to do was issue a paper about which people in Parliament would say, "If that's what they mean, we either don't give it back to them or we get rid of them". That is what consultative papers should be like. If you are chairman of one of the banks, all the most important consultative papers should be written in a way that you or an interested member of the public could realistically tune in to the debate and read it. That is hard. It is hard to write documents like that; it is not hard to write something long. That problem is not just to do with financial services. Recently, in the context of my new book, I read some of the WHO health regulations, and the most important substantive provisions are buried in process provisions. It is hopeless. I know nothing about the subject but I could see that it was not done well. It is hard to do it well. It is not a talent; it just takes effort. If you make that effort then it probably means that you can issue fewer consultative documents.

My final point is that the relationship needs to be symmetrical. For every time that you see a bunch of bankers, asset managers, water company people or whatever—particularly if you see them in a closed meeting that is not televised and a transcript is not issued—you really must see the other point of view as well. I do not think we did this well enough when I was there and I feel very strongly about it. The way that capture works is not just that maybe there will be a very well-paid job at the end; it is a kind of cognitive capture. If you live in a world where the way that you think about an issue is framed entirely by your dialogue with the industry—which, by the way, might sometimes be right—you are more likely to make a mistake than if you are also talking to other people who

sit there and say, "This is all rubbish, of course". You should be saying, "Is it rubbish? Why is it rubbish? What have I got to say to them?"

The issue comes back to consumers. Whatever the answer is to consulting with industry, one then needs to say, "How can we make the equivalent thing work for consumers?" It cannot be exactly the same mechanically; even in relatively dispersed industries there are only a few hundred or whatever, whereas obviously there are millions of real people. It needs to be symmetrical so that no one thinks the industry has the inside track.

A Member of your House, in something else I am involved with, recently made a very good point about the "principle versus rules" debate: "Under a rules-based approach, the big firms always do best because they can hire an army of lawyers." That is completely true but it does not make the point that he wanted to make, because if you have a principles-based approach then the big firms can employ hundreds of lobbyists and opinion formers who will be out there at dinners, lunches and conferences. If you go to any conference in financial services, compared with 30 years ago, it is full of people who have no role in the day-to-day running of the business. If you go to the Mansion House banquet, compared with when I was Robin's private secretary, there are very few people there actually running the banks. Instead, all the people who do that handle the Bank of England and the FCA stuff.

I have no complaints about how the firms organise their affairs, but the regulators—Ofgem, Ofcom and everyone else—should be trying to say, "No, no. We want to reach past this to the chair, CEO and consumers". You asked, "How?" I do not know. It is hard work and, since it has not been tried, people need to figure it out.

On your thing about sewage, which I was going to raise if you did not, I say: goodness gracious.

Q28 The Chair: Paul, thank you for a very rich session. You have helped us to clarify some of the lines of inquiry that we will take up with the regulators—Ofwat is the next one. When we did our inquiry into the transition to net zero, we looked very carefully at the role of Ofgem and considered that it was already overloaded, had far too much to do and did not have the resources to do it. So we proposed a different institutional arrangement there. More recently, we have looked at the reinsurance market—both the PRA and the FCA play a role there. There was an issue about whether competitiveness—"having regard to"—should play a role there. The Government will opine on that shortly. That is the work that we have done so far.

Which regulators come to your mind as being deserving of a closer look, possibly in the context of their role not being perceived to be very effective, in terms of public awareness of the problems that they are supposed to be looking at?

Sir Paul Tucker: One that comes to my mind is Ofcom, although I am not sure that it speaks to your last point. I will raise something

interesting about Ofcom—it goes back to France. Completely separately from the exercise there that I referred to, the French content regulator is separate from the economic one, because the view was taken at various levels in Paris that, if you put them together, they would be too powerful. The original title of my book was “Overmighty Citizens”. The question is, if you are the chief executive of Ofcom, are you an overmighty citizen because you are in charge of content and the economics? You can see that people think that this is very important—I have no comment on any of the individuals, some of whom I know—in relation to the debate about who was wanted as chair. This goes back to the earlier discussion about the chair and the CEO. Obviously, people thought the chair mattered—so who is in charge? The chair, the board or the CEO? When I discussed this with Ofcom, in the context of writing this book, it said, “Actually, we do have a different content committee that is a sub-committee of the board”. I said, “That is very good. Does it take decisions?” It said, “No, it just gives advice. The decision-maker is someone else”. That is not the same.

The reason why the Bank of England has this structure with the MPC, FPC and PRA is that we—I—wanted very clear decision-makers and a situation where the majority on each committee only did that. That seemed to me to be the best protection against the view in the Treasury in the mid-1990s that, if the Bank were responsible for monetary policy, it could not possibly do the banking stuff because it would be an overmighty citizen—those words came from Terry Burns. I hope that the governor is not an overmighty citizen, because he is actually in a minority on each committee.

Ofcom is not so well designed. Who is in charge of the content regulation, especially now that it covers the BBC? In a footnote in my book, I say that the Clementi review of BBC regulation—David is a friend of mine—talks about everything, including the pros and cons of the BBC self-regulating and having this in Ofcom or a separate regulator. But it does not talk about one thing: whether Ofcom would be fit for purpose if it had this extra function. My answer to Lord Agnew was that that would have been discussed in the United States and France, whereas we think, “Is it going to be any good?”, not, “Hold on, is this giving away too much?”

On Ofcom, if I were designing this, I do not know where I would end up, but concentrations of power matter. In a sense, the FCA—or the old FSA—had consumers here and stability there and could not find a way of trading them off. Then there was the financial crisis—so that went away. But the FCA was also not very well designed, in terms of the board and the CEO.

Q29 The Chair: Finally, I invite you to comment on the FCA, which has been a candidate that we have discussed around this table. A number of other witnesses have also talked to us about it being a suitable case to be looked at, particularly in the context of it having such a wide brief and whether it has adequate resources to do the job. They have also talked about whether it would or should be a question of going back to first

principles and deciding what it should concentrate on and whether parts of it should be hived off. How would you respond?

Sir Paul Tucker: That would be a good idea. I recently heard a dreadful suggestion—from some other body doing a review of regulators—on remerging the PRA and the FCA. I would oppose that view if I were you and if you care about Britain and its citizens.

There is another model that Sarah Hogg was keen on for a while. Actually, I may be mixing people up—Sarah floated the idea of the market regulation coming into the Bank, and I said that I thought that that would make the Bank too powerful. But there was another model that she may also have thought about, which involved taking the FRC and taking the market regulation part out of the FCA, leaving the consumer part. But, on the whole, those kinds of architectural things are very appealing to Ministers, mandarins and media commentators because you think you can get your head around them and write a little article or note on them—whereas the really big question about the FCA is: how do those three objectives fit together? Each of them is vague and they are equally ranked, so they are on a hiding to nothing.

One solution would be to make it less independent. Make it independent in its adjudicatory decisions—you do not want Ministers involved in those—but less independent in policy. I am not advocating that, but I am saying that, if you are going to have an independent FCA, you had better have clear objectives or a different kind of control. In the States, this is handled by annual budgetary decisions on the SEC each year. On those budget decisions, as you know, although Congress cannot pass ordinary legislation, the appropriations decision has proscriptions and prescriptions. So it will say, “Don’t do any work” or “You’re not allowed to spend any money on X”. The commission is highly political; when the Administration changes, it goes from being 3:2 in favour of the Republicans to 3:2 in favour of the Democrats. I do not love that model, but perhaps it is better than where we are.

The Chair: That concludes the meeting. Thank you very much for joining us.